

MINNESOTA  
STATE  
BOARD OF  
INVESTMENT

DATE: January 26, 2007

07 - 0309



TO: The Honorable Tim Pawlenty  
Members of the Minnesota Legislature

FROM: Howard J. Bicker, Executive Director

SUBJECT: External Money Manager Report Pursuant to Minnesota  
Statutes Section 11A.04, clause (12)

**Board Members:**

Governor  
Tim Pawlenty

State Auditor  
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*Minnesota Statutes*, Section 11A.04, clause (12) requires the State Board of Investment (SBI) to report annually to the Governor and Legislature the cost and investment performance of external investment managers employed by the Board.

On June 30, 2006, the SBI utilized 32 domestic stock managers, 15 international stock managers and 8 bond managers for the retirement assets under its control. As a matter of policy, the SBI allocates approximately one third of domestic stock to active management, one third to semi-passive management and one third to passive management; and approximately one half of all bonds to active management and one half to semi-passive management. As a matter of policy, the SBI allocated approximately 60 percent of international stock assets to active management and approximately 40 percent to passive management, of which about 11 percent was semi-passively managed. The investment performance of each manager, as well as the fees paid to each, are reported in the charts on the following pages. This information is also included in the Board's annual report for FY06. Please note that the SBI funded six new active domestic stock managers, four new active international managers, and three new semi-passive international managers at the beginning of the fiscal year.

It is important to note that all performance data reported by the SBI is *net* of fees and transactions costs associated with the various portfolios. The SBI's FY 2006 Annual Report contains additional detail on manager performance and may be accessed online at [www.sbi.state.mn.us](http://www.sbi.state.mn.us).

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### **Domestic Stock Managers**

The SBI evaluates domestic stock manager returns against the performance of Russell style indices which reflect the managers' specific investment approaches. The benchmark portfolios take into account the market forces that at times favorably or unfavorably impact certain investment styles. The aggregate domestic stock program is designed to outperform the Russell 3000 Index. Assets are allocated to managers within each Russell style index in the same proportion as in the Russell 3000 Index.

As a group, the managers underperformed the broad market by 0.7 percentage point for the fiscal year. The active and semi-passive components underperformed the respective benchmark. Fourteen active managers outperformed; fourteen active managers underperformed. Two semi-passive managers outperformed; one underperformed. The passive manager added 0.1 percentage point to the Russell 3000 benchmark.

### **International Stock Managers**

The SBI evaluates international stock managers against market indices published by Morgan Stanley Capital International (MSCI). Two indices are used: the World ex U.S. (net) and the Emerging Markets Free (EMF). As a group, the international stock managers outperformed the MSCI Country World Index (ACWI) ex U.S. (net) index by 0.3 percentage point for the fiscal year. Five of the eight EAFE managers outperformed the index; two of the three emerging markets managers outperformed EMF. All three semi-passive EAFE managers outperformed the benchmark. The passive manager outperformed the MSCI World ex U.S. index by 0.2 percentage point.

### **Bond Managers**

The SBI evaluates the performance of its bond managers against the Lehman Brothers Aggregate bond index. All five active managers exceeded the benchmark. All three semi-passive bond managers outperformed the index for the year. As a group, the bond managers outperformed the broad bond market by 0.6 percentage point for the year.

Figure 16. Domestic Stock Manager Performance FY 2006

	Actual Return	Benchmark Return
<b>Active Managers</b>		
<b>Large Cap Core (Russell 1000)</b>		
Franklin Portfolio Associates	9.5%	9.1%
New Amsterdam Partners	6.1	9.1
UBS Global Asset Management	9.9	9.1
Voyageur-Chicago Equity	4.0	9.1
<b>Large Cap Growth (Russell 1000 Growth)</b>		
Alliance Capital Management	6.7	6.1
Cohen Klingenstein & Marks	-6.3	6.1
Holt-Smith & Yates	-0.2	6.1
INTECH	6.7	6.1
Jacobs Levy Equity Mgmt.	4.0	6.1
Lazard Asset Mgmt.	7.4	6.1
Sands Capital Mgmt.	3.1	6.1
Winslow Capital Mgmt.	10.3	6.1
Zevenbergen Capital	13.0	6.1
<b>Large Cap Value (Russell 1000 Value)</b>		
Barrow, Hanley	6.7	12.1
Earnest Partners	12.0	12.1
Lord Abbett & Co.	12.4	12.1
LSV Asset Mgmt.	15.3	12.1
Oppenheimer Capital	4.5	12.1
Systematic Financial Mgmt.	12.6	12.1
<b>Small Cap Growth (Russell 2000 Growth)</b>		
McKinley Capital	18.3	14.6
Next Century Growth	30.6	14.6
Summit Creek Advisors	6.1	14.6
Turner Investment Partners	18.3	14.6
<b>Small Cap Value (Russell 2000 Value)</b>		
Goldman Sachs	12.7	14.6
Hotchkis & Wiley	4.9	14.6
Martingale Asset Mgmt.	9.3	14.6
Peregrine Capital Mgmt.	11.8	14.6
RiverSource/Kenwood	16.0	14.6
<b>Semi-Passive Managers (Russell 1000)</b>		
Barclays Global Investors	10.0	9.1
Franklin Portfolio Associates	9.2	9.1
J.P. Morgan Investment Mgmt.	7.3	9.1
<b>Passive Manager (Russell 3000)</b>		
Barclays Global Investors	9.7	9.6
<b>Historical Aggregate</b>		
	8.9	9.5
<b>SBI Domestic Equity Asset Class Target</b>		
		9.6

Figure 18. Bond Manager Performance FY 2006

	Actual Return	Benchmark Return
<b>Active Managers</b>		
Aberdeen Asset Mgmt.	-0.6%	-0.8%
Dodge & Cox Investment Mgmt.	0.7	-0.8
Morgan Stanley Investment Mgmt.	0.9	-0.8
RiverSource Investments	-0.1	-0.8
Western Asset Mgmt.	-0.3	-0.8
<b>Semi-Passive Managers</b>		
BlackRock Financial Mgmt.	-0.4	-0.8
Goldman Sachs Asset Mgmt.	-0.5	-0.8
Lehman Brothers Asset Mgmt.	-0.7	-0.8
<b>Aggregate Bond Pool</b>	<b>-0.2</b>	<b>-0.8</b>
<b>Asset Class Target</b>		
Lehman Aggregate		-0.8

Figure 20. International Manager Performance FY 2006

	Actual Return	Benchmark
<b>Active Managers: Developed Markets</b>		
Acadian Asset Management	37.0%	26.9%
Fidelity Mgmt. Trust Company	27.5	26.9
Invesco Global Asset Mgmt.	25.1	26.9
J.P. Morgan Investment Mgmt. Co.	25.4	26.9
Marathon Asset Management	27.8	26.9
McKinley Capital Management	30.6	26.9
RiverSource Investments, LLC	28.5	26.9
UBS Global Asset Management	22.9	26.9
<b>Semi-Passive Managers: Developed Markets</b>		
AQR Capital Management	27.7	26.9
Fidelity Mgmt. Trust Company	27.5	26.9
State Street Global Advisors	28.9	26.9
<b>Active Managers: Emerging Markets</b>		
Alliance Capital Management	33.0	35.5
Capital International, Inc.	37.7	35.5
Morgan Stanley Investment Mgmt.	38.6	35.5
<b>Passive EAFE Manager: Developed Markets</b>		
State Street Global Advisors	27.1	26.9
<b>Aggregate International Pool</b>	<b>28.2</b>	
<b>Asset Class Target</b>		<b>27.9</b>

## External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2006

### Active Domestic Stock Managers (1)

Alliance Capital Management L.P.	\$	1,056,609
Barrow Hanley Mewhinney & Staus, Inc.		819,942
Cohen Klingenstein & Marks		788,747
EARNEST Partners		252,470
Enhanced Investment Technologies, LLC		1,276,123
Franklin Portfolio Associates		407,785
Goldman Sachs Asset Management		638,359
Holt-Smith & Yates Advisors		433,587
Hotchkis and Wiley Capital Management, LLC		1,187,183
Jacobs Levy Equity Management, Inc.		584,166
Kenwood Capital Management, LLC*		0
Lazard Asset Management Group, LLC		175,504
Lord Abbett & Co LLC		792,945
LVS Asset Management		1,371,238
Martingale Asset Management L.P.		943,294
McKinley Capital Management Inc.		1,214,867
New Amsterdam Partners, LLC		1,241,212
Next Century Growth Investors, LLC		894,307
Oppenheimer Capital		1,066,532
Peregrine Capital Management		1,519,224
Sands Capital Management L.P.		752,399
Summit Creek Advisors, LLC (Winslow-Small Cap.)		726,736
Systematic Financial Management		672,472
Turner Investment Partners, Inc.		960,961
UBS Global Asset Management (Brinson)		1,321,575
Voyageur Asset Management, Inc.		258,099
Winslow Capital, Inc. -Large Cap.		234,667
Winslow Capital Management, Inc. -Small Cap.~		0
Zevenbergen Capital Investments, LLC		1,064,055

### Passive Domestic Stock Managers (2)

Barclays Global Investors		811,641
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### Semi-Passive Domestic Stock Managers (2)

Barclays Global Investors		3,096,834
Franklin Portfolio Associates		1,939,813
JPMorgan Fleming Asset Management		2,393,021
RiverSource Investments		392,043

### Active Domestic Bond Managers (2)

Aberdeen Asset Management (Deutsche)		1,586,019
Dodge & Cox		1,055,063
Morgan Stanley		1,272,014
RiverSource Investments (American Express)		901,855
Western Asset Management		1,362,894

## External Stock and Bond Managers' Fees

Total Payments for Fiscal Year 2006

### Semi-Passive Domestic Bond Managers

BlackRock Inc.	\$	983,956
Goldman Sachs		1,270,110
Lehman Brothers Asset Management, LLC (Lincoln)		556,727

### International Stock Managers (2)

Acadian Asset Management		1,366,494
Alliance Capital Management		1,782,240
AQR Capital Management		1,188,396
Britannic Asset Management (Blairlogie)~		0
Capital International		2,309,076
Fidelity Management Trust Co.- Active		760,642
Fidelity Management Trust Co.- Index		1,099,803
Invesco Global Asset Management		1,403,472
JP Morgan Flemming		1,325,630
Marathon Asset Management		2,087,615
McKinley Capital Management		1,355,720
Morgan Stanley Investment Management		2,810,188
RiverSource Investments(American Express )		1,020,230
State Street Global Advisors - Alpha		1,137,327
State Street Global Advisors		376,640
T. Rowe Price International, Inc.~		0
UBS Global Asset Management (Brinson)		1,287,951

### Assigned Risk Plan

GE Investment Management	258,833
Voyager Asset Management	245,268

\* Manager Terminated in Fiscal '06

~ Manager Terminated June 30, 2005

- (1) Most active stock managers, with the exception of Emerging Equity Managers, are compensated on a performance-based fee formula. Four fee options are available and fees earned range from zero to twice the manager's base fee, depending on the manager's performance relative to an established benchmark.
- (2) Active bond managers and semi-passive bond managers are compensated based on a specified percentage of assets under management.